

ISSUE DATE: January 11, 2000

DOCKET NO. E-002/M-96-1405

ORDER APPROVING POWER PURCHASE AGREEMENT WITH EPS/BECK POWER,
LLC

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Gregory Scott
Edward A. Garvey
Joel Jacobs
Marshall Johnson
LeRoy Koppendrayner

Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of Northern States Power
Company's Petition for a Variance From
Competitive Bidding for Biomass Phase II
Resources

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ORDER APPROVING POWER PURCHASE
AGREEMENT WITH EPS/BECK POWER, LLC

PROCEDURAL HISTORY

On January 11, 1999, NSP filed two separate requests: one for Commission approval of a power purchase agreement for 25 MW of biomass-fueled generation with St. Paul Cogeneration, LLC (District Energy), the other for Commission approval of a power purchase agreement for 25 MW of biomass-fueled generation with EPS/Beck Power, LLC (EPS/Beck). The Company's requests were assigned to this docket, E-002/M-96-1405.

On January 22, 1999, NSP filed a corrected summary of its filing and amended Exhibit B.

On March 12, 1999, the Minnesota Department of Public Service, now the Department of Commerce, (the Department) filed its comments, recommending that the Commission impose substantial modifications and approve the two Power Purchase Agreements (PPAs) so modified.

On March 29, 1999, reply comments were filed by NSP, the Department, the Residential Utilities Division of the Office of the Attorney General (RUD-OAG), the Izaak Walton League of America (IWLA), and Sustainable Energy for Economic Development Coalition (SEED) the Izaak Walton League of America (IWLA), and Sustainable Energy for Economic Development Coalition (SEED).

On April 16, 1999, Supplemental Comments were filed by EPS/Beck, NSP, the Department, the RUD-OAG, the IWLA, and SEED.

On April 19, 1999, ME3 filed Supplemental Comments.

On July 6, 1999, NSP, EPS/Beck, and District Energy filed a joint motion for a protective order pursuant to Minn. Stat. § 216A.05 and 471.705.

On August 5, 1999 the Commission issued its ORDER DEFERRING CONSIDERATION OF BIOMASS GENERATION PROPOSALS in Docket No. E-002/M-96-1405. In this Order the

Commission did three things:

- deferred a decision on the two 25 MW Purchased Power Agreements (PPAs) to allow EPS/Beck to develop a proposal for a 50 MW project;
- encouraged District Energy to improve upon its proposal for a 25 MW project;
- ordered NSP to meet with the Minnesota Valley Alfalfa Producers Cooperative (MnVAP) to determine the status of their project and whether some or all of the 75 MW currently committed to MnVAP is now uncommitted.

On October 11, 1999, NSP filed its Biomass Report in response to the August 5, 1999 Order.

On October 29, 1999, the Department of Commerce (Department) filed comments recommending rejection of the PPA with EPS/Beck and recommending that the Company negotiate an new agreement for a larger facility.

Also on October 29, 1999, the Office of Attorney General's Residential Utilities Division (OAG-RUD) filed comments supporting approval of the EPS/Beck project.

On November 8, 1999, the Izaak Walton League of America (IWLA) supporting approval of NSP's contract with EPS/Beck.

On November 12, 1999, EPS/Beck filed reply comments to the comments of the Department, OAG-RUD and the IWLA.

On November 15, 1999, NSP filed comments in response to the Department, OAG-RUD and the IWLA.

On December 10, 1999, NSP filed a letter with the Commission indicating that the 75 MW power purchase agreement with MnVAP had been terminated as of December 9, 1999.

The Commission met on December 20, 1999 to consider this matter.

FINDINGS AND CONCLUSIONS

I. BACKGROUND

Northern States Power Company (NSP or the Company) is contracting for biomass generated energy in order to meet the "biomass mandate" (Minn. Stat. § 216B.2424). This mandate is part of broader legislation that allows NSP to store spent fuel at its Prairie Island facility if it meets this biomass mandate and certain other requirements.

Minn. Stat. § 216B.2424 (1996) requires the Company to construct and operate, or purchase by December 31, 1998:

- **50 MW** of installed capacity generated by farm-grown, closed-loop biomass to be operational by December 31, 2001 (**Phase I**).

- An additional **75 MW** of installed capacity, similarly generated, to be operational by December 31, 2002 (**Phase II**).

As of December 9, 1999, NSP had no approved, operative PPAs to produce any of these required amounts. A PPA between MnVAP and NSP to produce 75 MW of installed capacity, operational by December 31, 2001 (**Phase I**), was approved by the Commission in an Order dated April 22, 1999. See *In the Matter of the Petition by Northern States Power Company for Approval of its Biomass Phase I Power Purchase Agreement with Minnesota Valley Alfalfa Producers*, Docket No. E-002/M-95-54, ORDER APPROVING POWER PURCHASE AGREEMENT, SUBJECT TO CONDITIONS (April 22, 1999). However, due to financial difficulties encountered by MnVAP compromising its ability to perform that contract, NSP has terminated that contract as of December 9, 1999.

In its previous consideration of this matter, the Commission has expressed its concern for the price of the two 25MW projects, particularly that of the District Energy project. The Commission also indicated its concern that economies of scale could be lost in developing two 25 MW biomass projects rather than one 50 MW project by EPS/Beck. Both of these concerns were highlighted in the findings and conclusions of the Commission's August 5, 1999 Order.

II. POTENTIAL EPS/BECK PURCHASED POWER AGREEMENTS

The record now contains cost estimates for three different-sized EPS/Beck projects: the original proposal for 25 MW and two additional proposals, one for 50 MW and another for 75 MW.

It also contains cost estimates for another 25MW project, proposed by St. Paul Cogeneration Project, LLC (District Energy) as well as the combined costs of the two 25MW projects as proposed by EPS/Beck and District Heating.

The record contains cost figures allowing comparisons of the different-sized projects in terms of net present value (NPV), average price per Mwh produced, and total payments, the main cost categories used by the Commission in its previous evaluations of the Phase II biomass projects.

III. PARTIES' RECOMMENDATIONS

All parties except the Department recommended that the Commission approve the EPS/Beck 25MW PPA rather than reject the 25MW size and require NSP to negotiate with EPS/Beck for a larger project.

A. THE DEPARTMENT

The Department noted that in its earlier comments of March and April, 1999, it had concluded that the average price per kWh for the 25 MW EPS/Beck project was too high and had specified the average price that should not be exceeded. In addition, the Department noted that since NSP is currently terminating its purchase power agreement with MnVAP, it is clear to the Department that the Company will not be able to meet its statutory biomass mandate and will have to request an amendment from the legislature. Given these circumstances, as well as the fact that even with approval NSP would still only be able to fulfill 40 percent of the mandate,

the Department argued that the Commission should not commit ratepayers to the price per Kwh of the EPS/Beck 25MW project. The Department pointed out that the EPS/Beck average price for the 25 MW project is significantly higher than the average price of both MnVAP and District Energy agreements.

The Department favored requiring NSP to negotiate with EPS/Beck for the larger (50 or 75KW) projects, noting the lower prices per KW available in these larger projects due to economies of scale. The Department argued that these prices should be set even lower by incorporating the potential subsidies from the Department of Energy and the production tax credit. Specifically, the Department proposed that the risk of receiving these benefits be shared between EPS/Beck and NSP's ratepayers with a 50/50 split.

The Department indicated that even with a 75 MW EPS/Beck project, NSP would still fail to meet the biomass mandate of 125 MW. However, accepting the Department's recommendation would encourage a more concerted effort to meet the mandate at more reasonable costs.

B. NSP

NSP suggested that even though the two 25 MW projects (EPS/Beck and District Heating) are higher than a 50 MW project by EPS/Beck, the two smaller projects combined are cost competitive with the single larger project. NSP found value in the technological and fuel diversity provided by having two projects since predicting the success of new technologies is very difficult, arguing that a strategy of relying on diversity increases the probability of the successful development of biomass projects.

NSP advised against ordering a larger EPS/Beck project which might preclude the Company from finding a potentially lower-cost solution for the remaining amount of the mandated amount. Also, the Company believes it would be appropriate to deal with the issue at that time rather than anticipate it now.

Replying to the Department, NSP stated that the Department's recommendation to negotiate a larger EPS/Beck agreement and provide guaranteed savings would result in the failure of the project and termination of the agreement. NSP noted that EPS/Beck has stated that it cannot assume the additional risks recommended by the Department and still obtain equity participation or financing. Compelling EPS/Beck to assume the risk of splitting government subsidies would make the project no longer viable, according to NSP.

NSP noted that the EPS/Beck 25 MW PPA contains an option to allow NSP to expand the project to as much as 75 MW up to six months after approval. NSP stated that this provision will allow it to place competitive pressure on other potential projects that the Company will need to examine due to the termination of the MnVAP PPA.

C. EPS/BECK

EPS/Beck recommended that the Commission approve the 25 MW project and reject the Department's recommendations. EPS/Beck suggested that the Commission could approve the PPA for 25 MW and allow NSP the flexibility to determine the actual size of the project and the role EPS/Beck will play in fulfilling the overall biomass mandate. According to EPS/Beck, approval of the 25 MW PPA will allow project development to begin and provide for the potential of a larger project.

EPS/Beck agreed that sharing the benefits and risks of a project are an important feature in contracts for projects of this type and noted that the EPS/Beck PPA does contain risk-sharing features for certain kinds of project costs. With regard to government subsidies, however, EPS/Beck argued that sharing the risk of receiving government subsidies would make the 50 MW project non-viable.

EPS/Beck stated that through its contact with federal officials it has learned that they would be very wary of a large biomass PPA in Minnesota. EPS/Beck suggested that the best way to secure government participation would be to approve the PPA in its current form, thereby providing momentum for the project and giving Minnesota's elected representatives an incentive to work on behalf of extending the production tax credit, and with encouraging the potential participation of the Department of Energy or Agriculture.

D. THE RUD-OAG

The RUD-OAG noted that it had originally encouraged the Commission to determine the viability of a 50 MW EPS/Beck project before approving either the District Energy or EPS/Beck project 25 MW projects. The RUD-OAG stated that it now supported approval of EPS/Beck's 25 MW PPA since the record now shows that the EPS/Beck 25 MW project and the 25 MW District Energy project, taken together, are no more costly than a potential EPS/Beck 50 MW project.

The RUD-OAG argued that by establishing EPS/Beck as a potential competitor to other providers for the remaining amount of Biomass Mandate, the Commission would be creating competitive pressure for any other projects that NSP will propose to meet the remaining amount of the Biomass Mandate. The RUD-OAG noted that the result of the Commission's August 5, 1999 Order establishing EPS/Beck as a potential competitor with District Heating had a very positive result, price revisions from District Heating that will save ratepayers more on its 25MW project than would be saved by imposing rate caps on larger EPS/Beck projects, as recommended by the Department. Finally, the RUD-OAG argued that by approving a total of 50 MW of biomass-generated electricity at this time (two 25MW projects) the Commission will leave NSP with more opportunities to achieve economies of scale in PPAs for the remaining amount: 75 MW.

E. IZAAK WALTON LEAGUE OF AMERICA

IWLA recommended approval of the EPS/Beck's 25MW PPA. IWLA stated that the project clearly qualifies under the mandate, and further delay would cause harm to both the developer and NSP's ratepayers. The fact that the price of this project remains above-market does not remove the obligation NSP has under the mandate, nor the Commission's obligation to approve the resulting PPAs as a matter of law.

IV. COMMISSION ANALYSIS AND ACTION

The PPA which the Commission addresses in this Order was entered into as part of NSP's statutory mandate (Minn. Stat. § 216B.2424, the Biomass Mandate) to purchase electricity generated using "farm-grown, closed-loop" biomass as fuel. The Commission has conducted its review of EPS/Beck's 25MW PPA pursuant to Minn. Stat. § 216B.1645 which requires the Commission to approve or disapprove PPAs entered into under the Biomass Mandate.

Having considered the comments and arguments of all the parties as well as all the documents filed in this matter, the Commission concludes that the record as developed in this matter does demonstrate that NSP's PPA with EPS-Beck, viewed in conjunction with the District Heating 25 MW project which the Commission approves in a companion Order, is reasonable and in the public interest. Accordingly, the Commission will approve this contract at this time.

In arriving at this conclusion, the Commission notes the benefit achieved for ratepayers resulting from the Commission's August 5, 1999 Order. In that Order, the Commission established EPS/Beck as a potential competitor for District Heating and directed District Heating to renegotiate its PPA with NSP. The Commission believes that it is valuable to foster a similar environment in which competitive forces can operate with respect to the remaining amount of the Biomass Mandate (75 MW).¹ Accordingly, the Commission views as important the fact that this Order establishes the potential for competition between EPS/Beck and other providers for a major portion (50 MW) of the remaining Biomass Mandate. The Commission is interested to learn what benefit will come from the fact that in its contract with EPS/Beck, NSP has the option for a six month period following Commission approval of the contract to expand the project up to 75 MW. The Commission will, therefore, direct NSP to report on the status of its use of this clause within 5 months of this Order.

At the same time, the Commission is conscious that economies of scale may make meeting the remaining 75MW obligation through one large-scale 75MW facility the most cost effective. The Commission is, therefore, not prejudging whether it is most economical to increase the size of the EPS/Beck facility. To do so would decrease the size of the remaining project, thereby possibly increasing the cost of the remaining project to a level that would render the total cost of generating the remaining 75MW greater than if the remaining 75MW were obtained via one project. In fact, preserving NSP's option to fulfill the remaining 75MW obligation through one large scale 75MW operation is a strategic public benefit that the Commission has considered in approving EPS/Beck's 25MW rather than rejecting it and requiring NSP to negotiate with EPS/Beck for a larger facility, as recommended by the Department.

ORDER

1. The Power Purchase Agreement between NSP and EPS/Beck for their proposed 25MW facility is approved.
2. Within five months of this Order, NSP shall report what action, if any, it has taken with respect to the escalation clause in its PPA with EPS/Beck, which gives NSP the option (for a six month period following Commission approval of the contract) to expand the EPS/Beck project up to 75 MW.

¹ With the December 9, 1999 termination of the MnVAP 75 MW contract and the approval of the two 25MW contracts (the 25MW contract in this Order and the District Heating 25MW project approved in a companion Order), the remaining amount of biomass generated electricity required under the Biomass Mandate but not currently under contract is 75MW.

3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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